

Message Text

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ACTION EUR-25

INFO OCT-01 ISO-00 SPC-03 AID-20 EB-11 NSC-10 RSC-01

CIEP-02 TRSE-00 SS-20 STR-08 OMB-01 CEA-02 CIAE-00

DODE-00 PM-07 H-03 INR-10 L-03 NSAE-00 PA-04 PRS-01

USIA-15 ACDA-19 IO-14 COME-00 NEA-10 SAJ-01 FRB-02

XMB-07 AGR-20 SIL-01 LAB-06 DRC-01 /228 W

----- 117667

R 301830Z OCT 73

FM AMEMBASSY BONN

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INFO AMEMBASSY LONDON

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C O N F I D E N T I A L SECTION 01 OF 03 BONN 15708

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E.O. 11652: GDS

TAGS: PFOR, EFIN, ECON, EAGR, ETRD, EC, GW, XH, XF

SUBJECT: SCHMIDT-STOESSEL TOUR D'HORIZON

1. SUMMARY, FINANCE MINISTER SCHMIDT EXPRESSED
ESPECIALLY OUTSPOKEN VIEWS IN DISCUSSION OCTOBER 29 WITH
ASSISTANT SECRETARY STOESSEL ON OFFSET, INTRA EC
RELATIONS, THE MID-EAST CRISIS, EC ECONOMIC AND MONETARY
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UNION, INTERNATIONAL MONETARY REFORM, THE CAP, FRG

EXPORT CREDITS TO THE EAST AND THE FRG DOMESTIC ECONOMIC OUTLOOK. SCHMIDT WAS HARSHLY OPPOSED TO THE USE OF FRG BUDGET FUNDS TO IMPROVE OFFSET OR BURDEN SHARING OFFERS -- HE WOULD FIGHT AGAINST "ANY MORE CONCESSIONS" TO THE US. HE EVENTUALLY YIELDED SOME GROUND, BUT ONLY TO THE EXTENT OF OFFERING "MEDIUM TERM OR LONG TERM" BUNDESBANK LOANS AT "MODERATE" INTEREST RATES TO BRIDGE THE WIDE GAP BETWEEN CURRENT US REQUEST AND FRG OFFER. END SUMMARY.

2. IN A WIDE RANGING DISCUSSION OVER ONE AND ONE HALF HOURS, ASSISTANT SECRETARY STOESEL, ACCOMPANIED BY ECONOMIC MINISTER WOOTTON, COVERED THE FOLLOWING SUBJECTS WITH FINANCE MINISTER SCHMIDT:

(A) ATLANTIC DECLARATION. SCHMIDT EXPRESSED HOPE THAT EC AND NATO WERE AT LEAST MEETING SUBSTANTIAL PORTION OF US WISHES ON ATLANTIC DECLARATION. FOLLOWING STOESEL'S STATUS REPORT, SCHMIDT COMMENTED "IT'S SO HARD TO KNOW TO WHOM TO SPEAK", ADDING THAT THIS PROBLEM WAS DIFFICULT ALSO FOR GERMANY. FOR EXAMPLE, THERE WAS WHAT POMPIDOU SAID AND THERE WAS WHAT WAS IN THE BACK OF HIS MIND. WHATEVER POMPIDOU'S VIEWS, GISCARD'S WERE DIFFERENT. AND THEN THERE WAS ALSO THE COMMISSION, WHICH SCHMIDT DISMISSED AS DEVOID OF POLITICAL SOPHISTICATION, EXCEPTING SOAMES AND ORTOLI.

(B) OFFSET. US AND FRG POSITIONS ON OFFSET AND BURDEN SHARING WERE DEBATED AT SEVERAL POINTS IN THE DISCUSSION. SCHMIDT TOOK ESPECIALLY HARD LINE, STATING ON SEVERAL OCCASIONS THAT HE WOULD OPPOSE ANY ADDITIONAL BUDGETARY CONCESSIONS TO THE US. HE INSISTED THAT PRESENCE OF US TROOPS IN EUROPE WAS AS IMPORTANT TO US SECURITY AS TO EUROPE'S AND IF US DIDN'T THINK SO, US SHOULD WITHDRAW THEM. HE ARGUED THAT IF US SENATE WISHED TO FORCE WITHDRAWAL IT WOULD DO SO, AND NOTHING FRG WOULD DO WOULD CHANGE SENATE ACTION. FOR HIM TO GIVE WAY, SCHMIDT CONTENDED, WOULD MEAN HIS POLITICAL DEMISE, AND HE WASN'T ABOUT TO COMMIT POLITICAL HARKIRI. NO GOVERNMENT WOULD REDISTRIBUTE BUDGET FUNDS

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AFTER THEY HAD BEEN ALLOCATED IN HARD CABINET INFIGHTING; TO SEEK TO DO SO WOULD CREATE MAJOR CABINET BATTLE WHICH COULD RUIN HIM POLITICALLY. FUTURE DEVELOPMENTS WERE STRICTLY TO BE THRASHED OUT BETWEEN AMBASSADOR HERMES AND UNDER SECRETARY CASEY; HE WOULD HAVE NOTHING MORE TO DO WITH OFFSET. SCHMIDT SAID HE REGRETTED HE HAD NOT SPOKEN OUT MORE OPENLY ON THE OFFSET QUESTION; HE WOULD WELCOME A PUBLIC DEBATE WITH

US CONGRESSIONAL SPOKESMEN. HE HAD TALKED TO US
SENATORS AND HE WAS SINGULARLY UNIMPRESSED. SCHMIDT
REFERRED REPEATEDLY TO GERMAN CONTRIBUTIONS TO
SUPPORTING DOLLAR, AND LOST HIS COMPLETE COOL ONLY
WHEN SPEAKING OF DM 20 BILLION RESERVE LOSSES FRG
CLAIMS TO HAVE SUSTAINED ON DOLLAR DEPRECIATION THIS
YEAR. AFTER MUCH DEBATE, SCHMIDT CONCEDED (1) FRG
COULD COMMIT ADDITIONAL BUDGET FUNDS TO IMPROVE CURRENT
DM 2.6 BILLION OFFSET OFFER IN FRG FY 75 BY MODEST
AMOUNT OF DM 100-200 MILLION, BUT NOT BY ANY SIGNIFICANT
AMOUNT AND (2) HE WOULD BE PREPARED TO BRIDGE GAP
BETWEEN US AND FRG POSITIONS BY "MEDIUM TERM OR LONG
TERM" CREDITS AT "MODERATE" INTEREST RATES EXTENDED BY

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BUDESBANK TO FEDERAL RESERVE OR TO TREASURY. THIS WOULD, HE SAID, CONSTITUTE PARTIAL CONSOLIDATION OF US DOLLAR OVERHANG WHICH HAD IN ANY EVENT TO BE SOLVED AS PART OF INTERNATIONAL MONETARY REFORM. (COMMENT. SCHMIDT WAS OBVIOUSLY NEGOTIATING HARD, ON OFFSET. HE HAS MADE HIS POSITION KNOWN BEFORE, HOWEVER, AND WE HAVE NO DOUBT THAT HE MEANT WHAT HE SAID -- GENERALLY SPEAKING. WE HELD OUT FOR HARD OFFSET THROUGH CONFIDENTIAL

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DEBATE. MOREOVER, WE CAN GET MORE HARD OFFSET THAN HE SUGGESTED -- BUT, WE THINK, NOT MUCH MORE. THEY ONLY POSSIBILITY FOR ANY SUBSTANTIAL CHANGE IN THE FRG OFFER WE SEE WOULD BE AS A RESULT OF A PUSH FROM THE HIGHEST LEVEL OF THE USG.)

(C) MIDDLE EAST. SCHMIDT WAS INTERESTED AS TO EFFECTS OF MID-EAST DIFFERENCES BETWEEN US ON LONGER TERM US-EUROPEAN RELATIONS. HE MADE "PERSONAL" ASSERTION THAT US SHOULD DISTINGUISH BETWEEN WHAT FRG DID AND WHAT FRG SAID DURING CRISIS. ON ONE HAND, FRG ALLOWED SHIPMENTS FROM ITS TERRITORY AND PERMITTED USE OF BASES HERE FOR REFUELING DURING AIRLIFT. ONLY AFTER CEASE FIRE IN EFFECT DID FRG SPEAK OUT AGAINST RESUPPLY AND THEN ONLY FOR CRITICAL POLITICAL EFFECT VIS-A-VIS ARABS. ISRAELI POLITICIANS WOULD, HE STRESSED, GRANT THE CONTRIBUTION THAT FRG HAD MADE. HE URGED THAT US AND FRG "COOL IT" IN PUBLIC STATEMENTS.

(D) INTERNATIONAL MONETARY REFORM. SCHMIDT TOOK HARD LINE THAT US HAD DESTROYED BRETTON WOODS ARRANGEMENT BY RAMPANT INFLATION FOLLOWED BY UNILATERAL DECISION TO SUSPEND CONVERTIBILITY. HE THOUGHT REFORM NEGOTIATIONS WERE PROCEEDING WELL BUT STRESSED THAT US HAD TO ACCEPT THAT US DOLLAR WOULD BE CURRENCY JUST LIKE ANY OTHER -- MARK, FRANK, OR YEN -- AND THAT US WOULD HAVE TO SUBMIT TO "RIGID" CONVERTIBILITY RULE. FRENCH HAD COME A LONG WAY, HE FELT. GISCARD WAS READY TO CONSIGN GOLD TO RELATIVE OBSCURITY, ALTHOUGH POMPIDOU MIGHT NOT YET BE FULLY CONVINCED. THERE WERE INDEED MANY CROSS CURRENTS OF OPINION IN PARIS, JUST AS THERE WERE IN WASHINGTON. UNDER COUNTERATTACK, SCHMIDT ADMITTED THAT MANY COUNTRIES SHARED THE BLAME OF THE DEMISE OF BRETTON WOODS. HOWEVER, HE WAS QUICK TO RETURN TO THE THESIS OF US RESPONSIBILITY, ESSENTIALLY BECAUSE OF VIET-NAM

INDUCED INFLATION AND RESULTANT EXTRAORDINARILY LARGE BALANCE OF PAYMENTS DEFICITS. SCHMIDT THOUGHT THAT COMPROMISE ON ADJUSTMENT PROCESS WAS WELL ON THE WAY; DOLLAR CONVERTIBILITY WAS, HE FELT, MAIN OBSTACLE TO OVERCOME TO COMPLETE REFORM.

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(E) ECONOMIC AND MONETARY UNION. SCHMIDT FORESAW NOTHING MORE THAN COSMETIC ADVANCE TOWARD EC ECONOMIC AND MONETARY UNION ON JANUARY 1. THERE WAS NO PROSPECT FOR HARMONIZATION OF MONETARY POLICY, FISCAL POLICY, OR OVERALL ECONOMIC POLITY AS LONG AS THE UK, IRISH AND ITALIAN CURRENCIES WERE NOT IN SNAKE. WHILE NOT WISHING TO OVERSTATE THE CASE, HE FELT THAT PRESENCE INSIDE SNAKE DID REQUIRE CERTAIN AMOUNT OF HARMONIZATION OF ECONOMIC POLITICIES IN FRANCE, BENELUX AND FRG. EC COMMISSION PROPOSAL FOR RESERVE POOLING WAS RIDICULOUS. PROPOSAL WAS FORMULA FOR UK AND ITALY TO SPEND FRG RESERVES IN ADDITION TO THEIR OWN AND HE WOULD NOT HAVE IT. FRG WOULD SUPPORT MODEST DEPRESSED REGION PROGRAM "TO MEET HEATH'S DOMESTIC POLITICAL REQUIREMENTS" BUT NOTHING MUCH WOULD HAPPEN ON JANUARY 1.

(F) CAP. COMMON AGRICULTURAL POLICY WAS HEIGHT OF ABSURDITY. CAP WAS, SCHMIDT ASSERTED, OPEN-ENDED COMMITMENT TO PAY FOR ANY AND ALL PRODUCTION BY EC FARMERS AT INFLATED PRICES. RESULTS WERE SURPLUSES, WHICH WERE THEN SUBSIDIZED FOR SALE TO USSR. NINE-TENTHS OF COMMISSION'S BUDGET WAS FOR ABSURD CAP AND THERE WAS NO WAY OF KNOWING WHAT THE FINAL COST WOULD BE UNTIL END OF YEAR -- IT WAS IMPOSSIBLE TO BUDGET FOR COSTS. DESPITE ABSURDITIES, SCHMIDT CONTINUED, THERE WAS NO PROSPECT FOR MAJOR OVERHAUL OF CAP AT PRESENT TIME; AT BEST ONLY MINOR ADJUSTMENTS COULD BE EXPECTED. FRG HAD NO DOMESTIC POLITICAL LIMITATIONS IN THIS REGARD; IT WOULD BE PREPARED TO REVAMP THE CAP DRASTICALLY. HOWEVER, FRENCH FARMERS, AND FRENCH GAULLISTS, WERE IMPLACABLE FOES TO ANY REAL REFORM; SOME FRENCH SAW CAP AS CORE OF COMMON MARKET. WHEN TOLD OF US CONCERNS RE POSSIBLE SOYBEAN CAP, SCHMIDT RESPONDED THAT HE WOULD NOT BE SURPRISED AT ANY ABSURDITY EC MIGHT INSTITUTE AS PART OF CAP. HE FORESAW, IN FACT, SERIOUS GRAIN SURPLUSES WITHIN A COUPLE OF YEARS.

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(G) EAST-WEST RELATIONS. SCHMIDT SAID HE ONLY GOT INVOLVED IN EAST-WEST AFFAIRS FROM STANDPOINT CREDITS TO EASTERN COUNTRIES. HE STRESSED HE WAS IMPLACABLY OPPOSED TO SUBSIDIZED INTEREST RATES TO USSR SUCH AS GRANTED BY US, UK AND FRANCE. THE ONLY EXCEPTION HE WAS PREPARED TO MAKE WAS FOR POLAND; IN THIS CASE HE WOULD GRANT LARGER SUBSIDIZED CREDITS THAN THOSE OFFERED SO FAR, BUT ONLY TO ACHIEVE RELEASE OF ETHNIC
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GERMANS WHO WERE PREVENTED CURRENTLY FROM EMIGRATING TO FRG BY POLISH REGIME. OTHERWISE, HE THOUGHT EAST-WEST TRADE SHOULD BE FINANCED AT COMMERCIAL INTEREST RATES. HE FORESAW US PROBLEM WITH EXCESSIVE TRADE SURPLUSES IN EAST-WEST TRADE IN FUTURE AND PREDICTED WE WOULD EVENTUALLY COME TO HIS VIEWS IN MATTER.

(H) US ECONOMIC PROJECTIONS. SCHMIDT SAID HE FORESAW, IN FACT, "EMBARRASSINGLY" LARGE TRADE SURPLUSES FOR US VERY SOON. HE RECOUNTED HOW HE HAD BET THAT US DOLLAR WOULD REACH DM 2.60 OR BETTER BY NEXT JUNE, AND STRESSED THAT IN CURRENT EXCHANGE RATE STRUCTURE US DOLLAR WAS UNDERVALUED AND DM OVERVALUED. FRG WOULD SOON BE IN DIFFICULTIES IN HIS VIEW.

(I) FRG ECONOMIC OUTLOOK. SCHMIDT FORESAW RAPID COOLING OF FRG ECONOMY WHICH HE "HOPED" COULD BE BROUGHT OFF WITHOUT A RECESSION. ASSUMING TIMING OF ECONOMIC POLICY CHANGE WAS RIGHT, SCHMIDT EXPECTED INTEREST RATES IN FRG TO FALL FROM CURRENT 10 PERCENT TO 9.5 PERCENT BY CHRISTMAS AND TO 8.5 PERCENT BY NEXT JUNE. UNEMPLOYMENT RATE WOULD BE UP SHARPLY; IF UNIONS WERE SUCCESSFUL IN CURRENT BID FOR 15 PERCENT WAGE INCREASE, RATE OF UNEMPLOYMENT IN 1974 WOULD BE EVEN HIGHER THAN HE ALREADY FEARED. FRG FIRMS SIMPLY COULD NOT AFFORD TO PAY INFLATED WAGE RATES UNIONS WERE DEMANDING. WHILE COOLING WAS ALREADY UNDERWAY, FRG COULD NOT TAKE FOOT OFF BRAKES GIVEN UNION PRESSURES. THERE WERE INCREASING NUMBERS OF BANKRUPTCIES, PARTICULARLY IN CONSTRUCTION INDUSTRY, AND OF BANK FAILURES. UNFORTUNATELY, THERE HAD TO BE EVEN MORE TO GET ECONOMY IN LINE. AMONG OTHER OBJECTIVES, SCHMIDT HOPED TO GET NUMBER OF FOREIGN LABORERS DOWN FROM ABOUT 2.5 MILLION, OR 10 PERCENT OR MORE OF LABOR FORCE. REDUCTION HE SOUGHT WOULD BE NET REDUCTION IN LABOR FORCE IN FRG, WHICH GERMAN INDUSTRY COULD OFFSET BY INVESTMENT ABROAD. IN RESPONSE QUERY, SCHMIDT SAID HE WAS HOPEFUL GERMAN INDUSTRY WOULD STEP UP INVESTMENT IN USA. INDUSTRY WAS TOO SLOW, HOWEVER, AND WAS FAILING TO TAKE ADVANTAGE OF ESPECIALLY FAVORABLE EXCHANGE RATE. HE CHASTISED VOLKSWAGEN SPECIFICALLY, NOTING THAT HE HAD PUBLICLY URGED VW TO

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ASSEMBLE AND TO PRODUCE CARS IN US. DESPITE CURRENT LARGE FRG EXPORT SURPLUS, THERE WAS NO BASIS FOR EXPECTATION THAT SITUATION WOULD CONTINUE. ONCE WORLD ECONOMY SLOED, AS HE EXPECTED IN 1974, US, UK AND FRENCH DELIVERY TERMS WOULD IMPROVE AND GERMAN EXPORTS COULD THEN ONLY COMPETE ON PRICE BASIS -- THEIR CURRENT

DELIVERY ADVANTAGE WOULD BE ELIMINATED. SINCE GERMAN
EXPORTS MORE EXPENSIVE, THEY WOULD TAIL OFF RAPIDLY,
CONTRIBUTING TO COOLING PROCESS SHCMIDT IS SEEKING.HILLENBRAND

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Message Attributes

Automatic Decaptioning: X
Capture Date: 01 JAN 1994
Channel Indicators: n/a
Current Classification: UNCLASSIFIED
Concepts: n/a
Control Number: n/a
Copy: SINGLE
Draft Date: 30 OCT 1973
Decaption Date: 01 JAN 1960
Decaption Note:
Disposition Action: RELEASED
Disposition Approved on Date:
Disposition Authority: garlanwa
Disposition Case Number: n/a
Disposition Comment: 25 YEAR REVIEW
Disposition Date: 28 MAY 2004
Disposition Event:
Disposition History: n/a
Disposition Reason:
Disposition Remarks:
Document Number: 1973BONN15708
Document Source: CORE
Document Unique ID: 00
Drafter: n/a
Enclosure: n/a
Executive Order: GS HILLENBRAND
Errors: N/A
Film Number: n/a
From: BONN
Handling Restrictions: n/a
Image Path:
ISecure: 1
Legacy Key: link1973/newtext/t1973105/aaaaadim.tel
Line Count: 388
Locator: TEXT ON-LINE
Office: ACTION EUR
Original Classification: CONFIDENTIAL
Original Handling Restrictions: n/a
Original Previous Classification: n/a
Original Previous Handling Restrictions: n/a
Page Count: 8
Previous Channel Indicators:
Previous Classification: CONFIDENTIAL
Previous Handling Restrictions: n/a
Reference: n/a
Review Action: RELEASED, APPROVED
Review Authority: garlanwa
Review Comment: n/a
Review Content Flags:
Review Date: 08 AUG 2001
Review Event:
Review Exemptions: n/a
Review History: RELEASED <08-Aug-2001 by izenbei0>; APPROVED <21-Sep-2001 by garlanwa>
Review Markings:

Declassified/Released
US Department of State
EO Systematic Review
30 JUN 2005

Review Media Identifier:
Review Referrals: n/a
Review Release Date: n/a
Review Release Event: n/a
Review Transfer Date:
Review Withdrawn Fields: n/a
Secure: OPEN
Status: NATIVE
Subject: SCHMIDT-STOESSEL TOUR D'HORIZON
TAGS: PFOR, EFIN, ECON, EAGR, ETRD, EC, GE, XH, XF
To: STATE
Type: TE
Markings: Declassified/Released US Department of State EO Systematic Review 30 JUN 2005